F I S C A L   I M P A C T   R E P O R T

SPONSOR Munoz
ORIGINAL DATE 2/26/15
LAST UPDATED
HB

SHORT TITLE Eliminate Some Hold Harmless Reductions
SB 633

ANALYST van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
$0.0	($3,815.67)	($15,998.2)	($24,995.9)	($34,551.0)	Recurring	General Fund
$0.0	$3,815.67	$15,998.2	$24,995.9	$34,551.0	Recurring	Local Governments

Parenthesis ( ) indicate revenue decreases

Relates to SB 101, SB 266, SB 274, SB 555, SB 621; HB 421.

SOURCES OF INFORMATION
LFC Files

Responses Received From
New Mexico Municipal League (NMML)

SUMMARY

Synopsis of Bill

Senate Bill 633 eliminates the hold harmless phaseout for some municipalities and counties and implements a “maximum distribution” in its stead. Specifically, the bill creates a “maximum distribution” for municipalities, defined as follows:

- for a municipality with a population less than 10 thousand, total food and medical deductions for the month multiplied by the combined rate of all municipal local option gross receipts taxes for the month plus 1.225 percent; and
- for a municipality with a population 10 thousand or more, total food and medical deductions for the month multiplied by the combined rate of all municipal local option gross receipts taxes in effect in on January 1, 2007 plus 1.225 percent.

The bill provides that a municipality that, on or after January 1, 2016, does not have in effect and has not had in effect a municipal hold harmless gross receipts tax, receive the maximum distribution for that municipality. The distribution may be adjusted for a distribution made to a Tax Increment Development District.

The bill also creates a "maximum distribution" for counties, defined as follows:

- for a county that with a population less than 48,000, total food and medical deductions for the month multiplied by the combined rate of all county local option gross receipts taxes for the month; and
- for a county with a population 48 thousand or more, total food and medical deductions for the month multiplied by the combined rate of all county local option gross receipts taxes in effect in on January 1, 2007.

The bill provides that a county that, on or after January 1, 2016, does not have in effect and has not had in effect a municipal hold harmless gross receipts tax, receives the maximum distribution for that municipality. The distribution may be adjusted for a distribution made to a Tax Increment Development District.

The effective date of the provisions of the bill is January 1, 2015.

FISCAL IMPLICATIONS

The bill would have significant negative impact on the general fund, and a positive impact on local governments as compared with the status quo.

The bill takes eliminates the hold harmless distribution entirely for any local government that has imposed a hold harmless GRT, and the LFC staff analysis assumes this deters all cities and counties from implementing the local option hold harmless GRT. As such, the bill effectively restores hold harmless payments to the large municipalities and counties that were subject to the phaseout pursuant to Laws 2013, Chapter 160. Because small local governments are not subject to the phaseout, it is assumed they would not impose a local option hold harmless GRT as this would end their hold harmless distributions. Therefore this analysis assumes the bill has no impact on these small local governments.

The LFC staff analysis was based on actual FY14 hold harmless distributions, grown for the forecast period at the rate of food and medical distributions assumed in the February consensus revenue estimate. The LFC staff analysis centered on the large local governments[1], municipalities and counties with sufficient populations to make them subject to the hold-harmless phaseout. For these local governments, the analysis compared the hold harmless distributions under the phaseout to what the distributions would be with no phaseout. The difference between the two represents the loss to the general fund and the gain to the local governments.

The FY16 impact is a half-year impact, assuming the provisions of the bill would take effect January 1, 2016, halfway into FY16.

[1] Alamogordo, Albuquerque, Artesia, Carlsbad, Clovis, Deming, Espanola, Farmington, Gallup, Hobbs, Las Cruces, Las Vegas, Los Alamos, Los Lunas, Lovington, Portales, Rio Rancho, Roswell, Santa Fe, Silver City, Sunland Park, Bernalillo County, Chaves County, Curry County, Dona Ana County, Eddy County, Lea County, McKinley County, Otero County, San Juan County, Sandoval County, Santa Fe County, Valencia County.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency and equity. Due to the revenue reduction resulting from the bill revenues may be insufficient to cover growing recurring appropriations.

SIGNIFICANT ISSUES

The New Mexico Municipal League (NMML) supports the bill, noting it would restore hold harmless payments to local governments subject to the phaseout. NMML reports 12 municipalities would be negatively affected by the phase out of the hold harmless distributions even if the municipalities imposed the 3/8 percent hold harmless gross receipts tax.

NMML adds GRT revenue is the single most important revenue source to municipalities, representing up to 75 percent of a municipality's general fund revenues. The general fund of a municipality, like the general fund of the state, is the funding source for basic services such as police protection, fire protection, parks and recreation, cultural attractions and libraries to name a few. These services could be negatively impacted by the phase out of the hold harmless distribution.

In October 2013, staff of the Legislative Council Service, the LFC, the Department of Finance and Administration, the Taxation and Revenue Department, and the New Mexico Tax Research Institute met with representatives of the New Mexico Municipal League (NMML) and the New Mexico Association of Counties (NMAC) to discuss issues related to the phase-out of the food and medical hold-harmless distribution and the local option hold harmless GRT rate authority created in Laws 2013, chapter 160. The group discussed issues with the implementation of that legislation and policy options to address them. The main issues and respective options were:

- "Stacking" county and municipal 3/8 percent GRT authority as authorized under current statute could result in a 3/4 percent GRT rate increase in municipalities.

  The increase in the GRT could result in high rates in some municipalities. One option to address this issue is to amend statute to limit the imposition of the county option GRT to "rest of county." However, this could result in county hold harmless local option GRT revenue being insufficient to make up for lost hold harmless revenue. TRD analysis shows that, under this option, seven counties would not generate sufficient revenue to replace their hold harmless distributions, including four counties large enough to be automatically phased out. This option could be fine tuned to limit one or two of the authorized 1/8 percent increments imposed by counties to "rest of county" areas.

- Timing differences between the GRT imposition and the hold-harmless phase-out could result in local governments receiving a windfall during the phase-out period.

  Amending statute to "offset" the windfall could provide an incentive to impose a lower rate or to defer tax impositions until the additional money is needed to meet the loss from the hold harmless phase-out. This could be accomplished by accelerating the phase-out of hold harmless distributions to local governments in the event that the local option GRT revenue would exceed the hold harmless payments. Another option is to limit the imposition of local option GRT to the increment necessary to make up for lost hold harmless revenue.

- For some municipalities a 3/8 percent rate increase is not sufficient to make up for lost hold harmless revenue

Per TRD's analysis during the interim, several municipalities would face a net revenue loss after the hold harmless phase-out, even after imposing the maximum 3/8 percent GRT. Revenue shortfalls would not occur until later in the phase-out of the hold harmless distribution, and municipalities could generate excess revenue early in the phase-out by imposing the local option GRT increase. The timing of the phase-out could give local governments time to adjust budget priorities to prepare for an eventual reduction in revenue.

- Referendum vs. no referendum for imposition of local option GRT. Should the imposition be subject to referendum either by request of the local governing body or by petition of the voters?

  Statute changes to allow the imposition of any local option GRT increase to be subject to local referendum could be implemented in several ways. One option is to make any local option GRT imposition subject to referendum, while another option is to allow referendum on GRT increments that would generate revenue in excess of the reduction in the hold harmless distribution.

This bill appears to remove some of the incentive to impose the hold harmless GRT, as it would disqualify the local government from receiving a hold harmless distribution. This diminishes the upward pressure on local (and combined state and local) GRT rates.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The hold-harmless phaseout and hold harmless GRT rate authority provisions in current law (Laws 2013, Ch. 160) will remain in effect. Several other bills introduced in the 2015 session attempt to amend the hold harmless phaseout provisions imposed in Laws 2013, Ch. 160.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

PvM/bb/je